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SUBJECT: AMBASSADOR'S FAREWELL LUNCH WITH ECONOMY MINISTER SOLBES

1. Summary. During a farewell lunch with the Ambassador, Second Vice President and Minister of the Economy Pedro Solbes gave a tour d'horizon of the status of the 2005 budget, current and projected growth rates for the economy, government plans to ease the overheated housing market, and his take on the strengthening of the Euro against the dollar. On the housing market, he floated the idea of a sort of "owner's insurance" to bring more of the vacant rental stock onto the market. End Summary.

2. Minister Solbes noted that he was planning to return to Parliament immediately after the lunch in order to see the vote on the budget and all proposed amendments by the lower house. He anticipated no difficulties in the lower house vote. (Note: The budget was approved by the Chamber of Deputies November 18. End note.) The budget then goes to the Senate for consideration. Solbes is anticipating difficulty in getting the budget through the Senate, and believes there is a real possibility the Popular Party and a Catalan nationalist party will group together to ensure the budget does not pass. He noted that even if the budget was rejected by the Senate, it would return to the lower house and could be (and would be) passed by the Chamber of Deputies over the Senate veto. This would not be ideal, of course, and would cost the PSOE government political capital in the Senate.

3. Minister Solbes noted the "flash" statistics for the third quarter of 2004 indicate overall economic growth of 2.6 percent. The fourth quarter should show similar figures and he expects overall growth for 2004 to come in at 2.6 or 2.7 percent. He was much cagier in projecting growth for 2005, tied in part to the fortunes of Spain's major trading partners in Europe. He did say that optimists project 2.8 percent growth and the pessimists around 2.5-2.6 percent for 2005.

4. Solbes was fairly sanguine about the valuation of the Euro against the dollar. He noted that 70 percent of Spain's trade was with Euro zone partners and so Spain is feeling less immediate pressure than some other Euro zone countries that export more heavily to the United States. He noted, however, that softening demand from Germany and other Spanish trading partners because of their own export woes will eventually affect the Spanish bottom line. He believes the Euro will continue to rise against the dollar until one or the other of the parties takes action.

5. The Ambassador queried Minister Solbes about government plans to ease the overheated housing market throughout Spain. Low interest rates on mortgages coupled with low returns on other investment possibilities have led to heavy demand for real estate, steep increases in property values, and in increased mortgage indebtedness of Spaniards. Solbes indicated he expects interest rates to rise in 2005, although incrementally and not enough to crash the market.

6. Solbes said one area the government would like to affect is improving the rental market. Owner/tenant laws favor the tenant and a great deal of rental stock stays off the market. Solbes said he was looking for a way to provide rent insurance for owners and to shift eviction and collection responsibility to the insurer. He seemed to be trying out the idea and did not say whether the insurance would be provided by the private sector, a public/private partnership, or the government. The Ambassador noted that it might be simpler for owners to take action against defaulting tenants and evict or recover debts. Both agreed that bringing the potential rental stock into the market, especially in Madrid and Barcelona, would effectively slow the house purchase market. The idea, however, showed the government may be willing to take a creative (and potentially expensive) approach to a difficult problem.

7. Comment: Minister Solbes was relaxed and open in his comments. Given recent events, it was a conversation refreshingly empty of references to Iraq, U.S.-Spanish relations, and even the recent U.S. elections. Solbes is confident of passing the PSOE government's first budget reasonably intact, which would be a political victory for the man brought into Zapatero's government to reassure those

worried that a Socialist victory would mean an end to fiscal responsibility. Although recent local rumors have indicated Solbes' health was poor and he might leave the government sooner rather than later, he appeared in fine fettle.

ARGYROS